

CHAPTER 3D

ESTATE TAX

HIGHLIGHTS

- Tax Base The value of the adjusted taxable estate.
- Tax Rate Equal to the maximum allowable federal credit for which the taxpayer is eligible.
- Revenue 2001-01 \$891 million*
 2002-03 (estimate) \$646 million*
 2003-04 (estimate) \$404 million*
- Administration State Controller

*Includes estimated effects of estate tax phase-out (see Section 3 of this Chapter)

1. TAX OVERVIEW

In 1982, California voters approved an initiative to repeal the state Inheritance and Gift Tax law. The initiative, Proposition 6, provided for the imposition of the **Estate Tax**, and prohibited the imposition of inheritance taxes by the state or local governments.

Generally, estate tax is levied on the entire property holdings of an individual upon his or her death. The value of each estate is based upon the fair market value of the decedent's property and interests in property as of the decedent's date of death. The California estate tax is derivative of the federal estate tax. Under federal law, the estate tax is reduced by a credit for a portion of state inheritance or estate taxes paid, up to certain maximum levels. California's estate tax is equal to the taxpayer's maximum allowable federal credit. In effect, California "picks up" a share of the tax that would otherwise go to the federal government but does not increase the total tax liability of the estate.

2. FEDERAL TAXATION

In the case of estates of decedents who died during 2000, the federal government allows a \$220,550 credit against estate and gift taxes, effectively exempting estates worth \$675,000 or less, from taxation. Since the applicable credit amount applies to lifetime transfers as well as transfers at death, the value of an estate not required to pay estate tax may be lower if any part of the credit had been used for taxable gifts made during the decedent's lifetime. Property inherited by spouses is fully exempt from taxation.

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Under prior federal law, the applicable credit amount was set to increase to \$345,800 by 2006, effectively exempting cumulative transfers up to \$1 million from taxation. However, new federal law passed during 2001 (the Economic Growth and Tax Relief Reconciliation Act of 2001) eliminates the federal estate tax over a nine year period beginning in 2002. Under new federal law, the \$675,000 exclusion is in effect during 2001. The exclusion amount rises to \$1 million in 2002 and 2003; to \$1.5 million in 2004 and 2005; to \$2 million in 2006, 2007, and 2008; and to \$3.5 million in 2009. The estate tax is completely repealed in 2010, but reinstated in 2011 (at an unknown level that will likely be determined in the time leading up to 2010).

3. REPEAL OF THE CALIFORNIA PICKUP TAX

The 2001 federal law also phases out the pickup tax credit over a four-year period beginning in 2002. The credit is reduced by 25% in 2002, by 50% in 2003, by 70% in 2004, and is entirely eliminated in 2005 and beyond. The State Controller estimates that the federal action will reduce state estate tax revenues by \$115 million in fiscal year (FY) 2001-02, by \$420 million in FY 2002-03, by \$770 million in FY 2003-04, and will entirely eliminate estate tax revenues in FY 2004-05 and beyond.

4. ADMINISTRATION

The California estate tax is a self-assessed tax, administered by the State Controller's Office. The amount to be paid is equal to the maximum federal credit allowable, as calculated according to Federal Form 706. A check in this amount and a state return, along with a copy of Federal Form 706, must be sent to the Controller's Office within nine months after the death of the deceased.

5. CODE

Revenue and Taxation Code Sections 13301-14302 and Sections 16700-16950